RESOLUTE FINANCIAL




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Resolute Connections

In this month's newsletter we touch on a few topics relevant to today's headlines: stock market volatility, inflation and high gasoline prices. But all the news isn't dismal, tax-free municipal bonds are on sale which can make them a bargain for higher income tax payers.

If you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

Reflections on the Downturn

The stock market suffered an ugly downturn on Friday. Chances are, you knew it was coming. In fact, so did we.

Come again? Pretty much *everybody* knew that sometime, someday, probably before long, stocks would take a weird, unexpected plunge. The fact is, they do this more often than we realize; one-day drops of more than 2.8% have occurred 20 times since February of 2018 (down 4.6% on Feb. 5, down another 4.15% on the 8th). Make that 21 after Friday.

The trick isn't knowing that there will be a market free-fall sometime in the (probably) near future; the trick is knowing exactly *when*. Many prognosticators had a feeling that stocks would go into a long-term free-fall after that disastrous few days in the spring of 2020, when people were just realizing that Covid was going to be a thing. After the markets rewarded buy-and-hold investors, many were pretty sure the markets were going to plunge when President Trump was impeached the first time, and then the second time. There's a whole cadre of pundits who make a great living by predicting that some kind of investing or economic catastrophe is just around the corner, and they offer this prediction over and over again until one day (surprise!) they turn out to be right.

If you knew that there would be a 2.8% market drop on, precisely, April 22 of this year, then you had something worth talking about, and we wish you would have shared this information with us beforehand. The fact that none of us could predict the date or time is significant; it means that these market moves are completely predictable in that we know they are going to happen, and unpredictable in that we never have any idea beforehand when the hammer will fall.

But that's also good news. Just as experience tells us that the markets are going to drop periodically, it also tells us that they tend to recover to new highs later on. Neither of those rather vague predictions are terribly exciting, but the second one is the one that is going to make you money in the long run.

Sharing the Pain

There's no question that gasoline prices at the pump are awfully high currently. American drivers are paying an average of $4.69 a gallon, by recent estimates, compared with $2.87 a year ago. At these higher prices, it is projected that the average American will spend 3.1% of total income on gasoline each month.

Pretty awful, right? And you may be hearing that this is somehow connected to misguided U.S. government policies.

What you may not be hearing is that people in many other countries in the world are feeling the same pain at the pump—and many are feeling it more than we are in America.

Recently, an organization called GlobalPetrolPrices ranked gasoline prices for 119 countries. It found that U.S. prices are actually on the low side of the global spectrum. In Finland, a gallon of gas costs the equivalent of $9.20, while in Italy, Germany, Greece, the Netherlands, Norway, Sweden, Denmark and France, the cost ranges from $8.74 to $9.15. In the United Kingdom, a gallon of gas will set you back $8.06, compared with $8.38 in Israel.

Australians and Canadians are paying less, but still more than Americans: $5.38 and $5.95 a gallon respectively. Chinese citizens are paying $5.14 a gallon; Japanese consumers are paying $5.50, while in India, the cost is $5.09 a gallon.

So where are car drivers getting a bargain on their gas purchases? Mexicans are paying just $4.18 a gallon, and people in oil-producing states like Kuwait ($1.31), Qatar ($2.18) and Saudi Arabia ($2.35) are experiencing less pain at the pump. They may also be able to look out their back porch at major producing oil derricks.

During the current embargo on Russian oil and gas, and given uncertainty on the world markets, we can expect to hear a lot more political finger pointing. But it might be helpful to know that if Americans are victims of misguided government policies, then other countries would seem to need to look at their own energy policies as well.

Inflation Fears

The headlines are kind of alarming: last month, the U.S. inflation rate spiked to the largest increase since December of 1981. The Commerce Department's basket of consumer products was 8.5% more expensive in March than it was a year earlier.

Before anyone becomes too alarmed, they should know that half of that increase came at the gas pump, the aftermath of the energy disruptions associated with the ongoing war in Ukraine. Since then, gas prices have come down a bit, and there is no good reason to imagine that the pain at the pump is permanent.

More problematic is the rise in grocery prices, which are also impacted by the war. Both Russia and Ukraine are exporters of wheat; whenever supplies decrease, assuming constant demand, prices rise. Bread and a host of other food products suddenly become pricier.

Airline tickets are becoming more expensive because airlines are no longer begging people to take the Covid risk of flying. Airlines are paying more for fuel than they were a year ago, and manufacturers are still dealing with transportation bottlenecks.

None of this helps us understand why egg prices are up over 11% from last year, and the Easter ham that many Americans prepare over Easter weekend jumped up 14% in cost.

IS there an explanation? Part of the reason economists fear inflation is the mindset that it creates. When workers and companies see prices going up, they prepare for it by demanding higher wages and higher prices for their products. Barbers and massage therapists ask for a few dollars more for their services, and then a few dollars more because everybody else has raised prices—and so it goes. Suddenly—and nobody knows exactly where or how we cross that threshold—inflation becomes a self-fulfilling prophecy. And these cycles can be very difficult to stop.

Muni Bonds on Sale

The most interesting quirk in investor behavior is the tendency to sell when an investment goes down, and buy when it's going up. A case in point right now is municipal bonds.

By any measure, muni bond investments have experienced a terrible first quarter, 2022—in aggregate down 6.4%. That wouldn't be a dramatic decline for risk assets like stocks, but for usually-stable munis, the quarter ranks as a disaster. The culprit, of course, was rising interest rates; bonds issued at lower rates in the past suddenly became proportionately less valuable.

Municipal bonds can be especially interesting for people who are stuck in a high federal tax rate, because most of the bonds deliver income that entirely escapes federal taxes, and if they invest in bonds issued in their state, the income isn't taxed at the state level either. Investors calculate the 'tax-equivalent yield;' that is, the yield that they would have to receive from taxable corporate bonds in order to come to the same after-tax income. For a person who pays federal taxes at a 37% rate, the tax-equivalent yield of a muni paying 4% would be 6.92%. This comparison can be complicated, since it involves different states and different tax brackets, but the basic concept is easily illustrated.

Muni interest income also doesn't count toward the 3.8% 'net investment income tax' that serves as a drag on income from stocks and other bonds, and it doesn't increase the adjusted gross income on your tax return, which can be used to calculate the Medicare surtax.

What does any of this have to do with investing quirks? Last year, munis were popular with investors, to the point where they were selling at a yield equivalent to 67% of the yield on Treasury bonds of comparable maturity. The tax-equivalent yield was often less than with comparable corporate bonds.

Today, in stark contrast, thirty-year AAA municipals offer about 106% of the yield of comparable Treasuries. The tax-equivalent yields are the highest since late 2020—and at these fire sale prices, demand, due to the recent price decline, has dried up. At last count, $1.2 billion worth of muni bonds stood at auction, with no takers.

Source:
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For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.